Supreme Court, U. S.
FILED
MAY 6 1980
MICHAEL RODAK, JR., CLERK

No. 79-927

In the Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE PETITIONER

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-49a) is reported at 606 F.2d 1004.

JURISDICTION

The judgment of the court of appeals (Pet. App. 50a) was entered on March 30, 1979. A petition for rehearing was denied on July 16, 1979 (Pet. App.

51a-52a). On October 11, 1979, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including December 13, 1979. The petition was filed on that date and was granted on February 19, 1980. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under Section 4(c)(8) of the Bank Holding Company Act of 1956, the Federal Reserve Board may authorize bank holding companies to organize and manage closed-end investment companies to the extent permitted by the Glass-Steagall Act.

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are set forth in the Appendix attached to this brief.

STATEMENT

1. On February 1, 1972, the Federal Reserve Board (the "Board") promulgated a regulation which provides that serving as an investment adviser to a registered investment company[1] is an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8), and is therefore

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[1] The definition of "investment company" contained in the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, includes companies engaged primarily in the business of investing in securities. See 15 U.S.C. 80a-3(a). Certain investment companies are required to register with the Securities and Exchange Commission. 15 U.S.C. 80a-7, 80a-8.

permissible for a bank holding company.[2] 12 C.F.R. 225.4(a)(5)(ii) (Pet. App. 81a). An interpretive ruling accompanying the regulation, 12 C.F.R. 225.125 (Pet. App. 83a-87a), set forth the limitations that the Board concluded should be imposed on bank holding companies serving as investment advisers[3] to imple-

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[2] A "bank holding company" is defined in Section 2(a)(1) of the Bank Holding Company Act, 12 U.S.C. 1841(a)(1), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." Section 2(a)(2) of the Act, 12 U.S.C. 1841(a)(2), provides that "[a]ny company has control over a bank * * * if [*inter alia*] the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *."

The Board's determination that an activity is "closely related to banking" and thus is permissible for bank holding companies does not, by itself, authorize any particular bank holding company to engage in that activity. A bank holding company must apply to the Board for permission to engage in the activity. The Board is then required to determine whether the public benefits reasonably expected to result from the performance of the activity by the particular holding company outweigh any possible adverse effects. 12 U.S.C. 1843(c)(8). The Board also has authority to supervise holding companies so engaged to prevent the violation of federal laws or regulations and to ensure sound banking practices. 12 U.S.C. 1818(b)(1), (3); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3646.

[3] The Board's regulation authorizing bank holding companies to serve as investment advisers increased the types of fiduciary services that holding companies might provide. The Board had previously authorized fiduciary services such as advising real estate investment trusts, providing portfolio investment advice, furnishing general economic information, and providing financial advice to state and local governments. 12 C.F.R. 225.4(a)(5)(i)-(v).

ment the provisions of the Glass-Steagall Act.[4] In light of this Court's decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), the Board determined that certain activities ordinarily performed by investment advisers on behalf of investment companies are permissible for bank holding companies, while others are prohibited.[5]

The Board's interpretive ruling draws a distinction between open-end and closed-end investment companies. The ruling forbids a bank holding company serving as an investment adviser to organize or control an open-end investment company. An open-end investment company typically stands ready to sell and redeem its shares at any time and thus is continuously engaged in the process of issuing securities. 12 C.F.R. 225.125(f), (c).[6] Closed-end investment

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[4] The Banking Act of 1933, ch. 89, 48 Stat. 162, contains several provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks, such as bank holding companies and companies under common control with banks, in specified securities activities. See Section 16, 12 U.S.C. 24 Seventh; Section 20, 12 U.S.C. 377; and Section 21, 12 U.S.C. 378.

[5] In its interpretive ruling, the Board acknowledged that the Glass-Steagall Act was not modified by the Bank Holding Company Act Amendments of 1970 and that, accordingly, the Glass-Steagall Act's restrictions on securities activities of bank affiliates apply to bank holding companies serving as investment advisers. 12 C.F.R. 225.125(b), (e), (f).

[6] Open-end investment companies are known as "mutual funds." *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 625 n.11. Under the Board's interpretive ruling, a bank holding company may only provide investment advice to (as distinguished from organizing or controlling) an open-end investment company. 12 C.F.R. 225.125(c), (f).

companies, in contrast, do not stand ready to redeem their shares and do not issue their shares after initial organization except on infrequent occasions. In light of this difference, the Board's interpretive ruling permits a bank holding company to organize and control a closed-end investment company,[7] with the caveat that such management activities are permissible only if the investment company is not primarily or frequently engaged in the issuance of securities. 12 C.F.R. 225.125(f), (c). In addition, the Board's interpretive ruling expressly forbids a bank holding company to engage directly or indirectly in the sale or distribution of any securities issued by any investment company. 12 C.F.R. 225.125(h).

The interpretive ruling also imposes restrictions designed to eliminate potential conflicts of interest and unsound banking practices of the types discussed by this Court in *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630-634, 636-639. A bank holding company and its subsidiaries are forbidden to purchase for their own account securities of any advisee investment company or to purchase such securities for any other person in a discretionary fiduciary capacity. A bank holding company and its

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[7] This control is subject to the provisions of the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.* Under Section 10(a) of that Act, 40% of the directors of the client company must be independent of the investment adviser. 15 U.S.C. 80a-10(a). These independent outside directors are empowered, under Section 15 of the Act, to terminate the advisory contract with the investment adviser. 15 U.S.C. 80a-15(a), (c). See *Burks* v. *Lasker*, 441 U.S. 471, 482-483 (1979).

subsidiaries are also forbidden to extend credit to any such investment company or to accept its securities as collateral except in limited circumstances. 12 C.F.R. 225.125(g). To insure its complete separation from investment banking, every bank holding company is forbidden to distribute prospectuses or sales literature concerning its advisee investment company, and such materials may not be made available to the public at any office in the bank holding company system. Officers of subsidiary banks may not express opinions concerning the purchase of shares of an advisee investment company, and the names of bank customers may not be furnished to such investment company or its representatives. The Board's interpretive ruling also strictly limits the making of deposits on behalf of an advisee investment company in any subsidiary bank of an adviser holding company. 12 C.F.R. 225.125(h), (i).

2. In December 1973, respondent Investment Company Institute ("ICI"), a trade association of open-end investment companies, petitioned the Board to rescind its regulation and interpretive ruling. Respondent claimed that the regulation authorized activities violative of Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 12 U.S.C. 378, and for that reason could not lawfully be adopted by the Board under the Bank Holding Company Act. In March 1974 the Board denied respondent's petition (Pet. App. 53a-64a). With respect to Section 16 of the Glass-Steagall Act, which applies only to banks, the Board explained that its regulation and

interpretive ruling authorize activities only for bank holding companies and their non-bank subsidiaries rather than for banks (Pet. App. 60a-61a). Similarly, the Board pointed out that Section 21 of the Glass-Steagall Act does not apply to the activities of institutions such as bank holding companies that do not receive deposits (Pet. App. 54a-56a).

The Board further explained that the investment advisory activities authorized by its regulation are closely connected to conventional banking functions: "investment advisory services * * * ha[ve] been a traditional banking function as long as there have been banks" (Pet. App. 57a). The Board added that "banks historically have furnished investment advice to trust accounts; these include testamentary trusts, *inter vivos* trusts, executorships and guardianships, managing agency accounts and pension and profit sharing trusts. In all of these traditional trust activities, banks place orders with independent broker-dealer firms to buy and sell stocks and other securities" (Pet. App. 62a; see also A. 20).

Respondent filed a second petition for rescission of the Board's regulation and interpretive ruling after judicial review of the Board's first order was denied on jurisdictional grounds.[8] In August 1977, the Board denied respondent's petition and reaffirmed its previous determination (Pet. App. 65a-79a).

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[8] *Investment Co. Institute* v. *Board of Governors of the Federal Reserve System*, 398 F. Supp. 725 (D.D.C. 1975), aff'd, 551 F.2d 1270 (D.C. Cir. 1977).

3. Respondent sought review of the Board's denial of its petition for rescission in the United States Court of Appeals for the District of Columbia Circuit. The court of appeals expressly rejected respondent's contention that organization and control of a closed-end investment company by a bank holding company violate Sections 16 and 21 of the Glass-Steagall Act (Pet. App. 14a-23a). Nonetheless, even though neither respondent nor any other party had directly raised the issue in any forum, the court set aside the Board's regulation and interpretive ruling on the theory that the challenged regulation and ruling exceeded the Board's authority under Section 4 (c)(8) of the Bank Holding Company Act (Pet. App. 23a-46a).

The court found "virtually no guidance" on this question in the legislative history of the Bank Holding Company Act as originally enacted in 1956 (Pet. App. 30a). It concluded, however, that the Act's grant of authority to the Board to authorize bank holding companies to engage in "financial" and "fiduciary" activities "closely related" to the business of banking (70 Stat. 137) could not be construed to permit the management of closed-end investment companies because of the generally understood policy of the Glass-Steagall Act to divorce "investment from commercial banking" (Pet. App. 30a). The court also concluded that Congress, in amending the Bank Holding Company Act in 1970, believed that the Glass-Steagall Act prohibited bank holding companies from managing closed-end investment companies. The

court reached that conclusion even though it previously had rejected respondent's contention that the Glass-Steagall Act in fact had such a preclusive effect (Pet. App. 43a-44a).[9]

SUMMARY OF ARGUMENT

Resolution of the question presented in this case requires a two-fold determination. First, does the Glass-Steagall Act forbid a bank holding company to organize and manage a closed-end investment company? Second, if not, does the Bank Holding Company Act forbid a bank holding company to serve in that capacity?

I.

A. The court of appeals correctly rejected respondent's challenge to the Board's regulation and interpretive ruling under the Glass-Steagall Act. As the court of appeals and the Board both recognized, the Glass-Steagall Act prescribes different rules for banks and for bank "affiliates" (including bank holding companies and companies under common control with banks). Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 378, prescribe standards governing the securities activities of banks. The legal standard applicable to bank "affiliates," how-

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[9] After handing down its opinion, the court issued an order amending the opinion by adding a sentence stating that the court was withholding judgment on the question whether bank holding companies and their nonbank subsidiaries may "render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies" (Pet. App. 48a-49a).

ever, is the standard contained in Section 20 of the Glass-Steagall Act, 12 U.S.C. 377. Section 20 provides that a bank affiliate may not engage "principally" in the issuance or underwriting of securities. Section 20 thus prescribes a qualified prohibition. *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 447-448 (1947). The statute forbids a bank affiliate to engage principally or predominantly in the issuance or underwriting of securities, but does not forbid an incidental or remote involvement.

B. Under the Board's regulation and interpretive ruling, a bank holding company is authorized to "control" a closed-end investment company. Even if such a closed-end company is deemed a bank "affiliate" by reason of that control (see 12 U.S.C. 221a(b)(2)), the activities of a closed-end investment company do not violate the requirements of Section 20 of the Glass-Steagall Act. By definition, a closed-end investment company managed by a bank holding company pursuant to the Board's regulation and ruling does not engage "principally" in the issuance or distribution of securities.

The principal activity of a closed-end investment company is to invest and reinvest the assets that have been committed to the enterprise. A closed-end investment company issues its own shares only at the time of original organization and at infrequent intervals thereafter. It is identical in this respect with other corporations that "go public" by issuing stock. Unlike open-end investment companies, which con-

tinuously issue new shares to offset share redemptions, a closed-end company does not seek to replenish or increase its capital base after organization. For this reason, the Board consistently has distinguished between closed- and open-end investment companies in applying the restrictions of the Glass-Steagall Act. In addition, the Board's regulation and ruling expressly provide that bank holding companies may manage only closed-end investment companies that do not issue or distribute shares primarily or frequently. Thus, the activities of such companies cannot violate Section 20 of the Glass-Steagall Act. *Board of Governors of the Federal Reserve System* v. *Agnew, supra.*

C. A bank holding company managing a closed-end investment company is a bank "affiliate" subject to the restrictions of Section 20 of the Glass-Steagall Act. See 12 U.S.C. 221a(b)(4). Thus, it is necessary to ensure that such a bank holding company does not engage "principally" in the issuance or distribution of securities. The Board's regulation and ruling foreclose that possibility.

In organizing and managing an investment company, a bank holding company does not itself issue securities. Moreover, the Board's regulation and ruling provide that a bank holding company may organize and manage only a closed-end investment company, which issues securities only at the time of its initial organization or on infrequent occasions thereafter. The regulation and ruling also provide that a bank holding company serving as an investment

adviser may not "directly or indirectly" sell or distribute the shares of its advisee investment company. That underwriting task must be performed solely by an investment banker unaffiliated with the holding company. Likewise, a bank holding company and its subsidiaries are forbidden to distribute prospectuses or sales literature relating to the shares of its advisee investment company. Thus, even with respect to closed-end investment companies that issue securities only infrequently, the Board's regulation and ruling effectively divorce bank holding companies from the process by which securities are distributed. That segregation of the underwriting business from the business of managing investments further assures that the services performed by bank holding companies are "principally" fiduciary services, not investment banking services.

D. The Board's regulation and interpretive ruling also prescribe safeguards to prevent conflicts of interest and unsound banking practices of the kind that concerned Congress when the Glass-Steagall Act was enacted. The overriding purpose of the Glass-Steagall Act was to safeguard banks from losses resulting from participation in the speculative business of securities trading and investment banking. *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629-630 (1971). The Board's regulation and ruling serve that purpose. A bank holding company and its bank and non-bank subsidiaries are strictly forbidden to purchase interests in or lend money to an advisee investment company. 12 C.F.R. 225.125(g).

The Board's regulation and ruling also protect against the "more subtle hazards" (401 U.S. at 630) resulting from participation in investment banking. Under the Board's regulation and ruling, a bank holding company and its subsidiaries may not engage in the competitive business of selling investments. Promotional literature concerning the shares of investment company advisees may not be distributed at offices in the holding company system and the names of bank customers may not be furnished to persons distributing such shares. 12 C.F.R. 225.125 (h). Moreover, to avoid potential injury to a holding company's reputation that could result from the poor performance of its advisee's investment portfolio, the Board has prohibited a bank holding company from managing an investment company with a name similar to that of the holding company or any subsidiary bank. 12 C.F.R. 225.125(f). Finally, to prevent conflicts of interest, the Board also has forbidden a bank holding company and its subsidiaries to exercise fiduciary powers to purchase securities of an advisee investment company, and employees of subsidiary banks may not express opinions on the investment merits of the shares of an advisee investment company. 12 C.F.R. 225.125(g), (h).

These prophylactic rules assure that the remedial purposes of the Glass-Steagall Act are achieved in fact. The Board's determination that these safeguards suffice to implement the statutory objective and to protect the public interest is entitled to substantial judicial deference. *Ford Motor Credit Co.*

v. *Milhollin*, No. 78-1487 (Feb. 20, 1980); *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 450 (Frankfurter and Rutledge, JJ., concurring).

II.

A. Having rejected respondent's contention that organization and management of a closed-end investment company by a bank holding company infringe the Glass-Steagall Act, the court of appeals should have upheld the Board's regulation and interpretive ruling. Instead, however, the court of appeals concluded that Congress intended to foreclose such activities under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). That conclusion disagrees with the plain meaning of Section 4(c)(8).

Section 4(c)(8) authorizes the Board to permit bank holding companies to engage in non-banking activities that are "closely related" to banking. The statute does not, on its face, prohibit any particular activity. Instead, it delegates to the Board the discretionary task of drawing the line between permissible and impermissible activities. Nothing on the face of the statute suggests that the Board is powerless to authorize a bank holding company to organize and manage a closed-end investment company.

The structure of the Bank Holding Company Act reinforces this interpretation. Under Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), bank holding companies are expressly authorized to acquire any or all of the shares of an investment company. They may also manage, control, and provide services to a

subsidiary investment company. In light of Congress' express authorization to bank holding companies to own, manage, and control an investment company subsidiary, it is untenable to assert that Congress believed that rendering management services to a closed-end investment company was forbidden under the flexible standard of Section 4(c)(8).

B. The legislative history of Section 4(c)(8) shows that Congress intended to vest the Board with discretion to authorize non-banking activities closely related to banking. It also shows that Congress contemplated that the Glass-Steagall Act alone would serve as the touchstone to determine whether a particular activity results in an undue connection between commercial and investment banking. Congress did not intend to fashion a new standard of "securities-relatedness" under Section 4(c)(8).

The legislative history does not suggest that Congress believed that Section 4(c)(8) would foreclose bank holding companies from managing closed-end investment companies. To the contrary, the Senate Committee Report on the 1970 amendments to the Bank Holding Company Act shows that Congress believed that the Board could authorize bank holding company management even of open-end investment companies to the extent permitted by the Glass-Steagall Act. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 15 (1970).

C. Neither respondent nor the court of appeals questioned the Board's factual determination that

management of a closed-end investment company is an activity "closely related" to banking. In light of the explicit provision contained in Section 4(c)(7) of the Bank Holding Company Act, which authorizes bank holding companies to acquire and manage their own investment company subsidiaries, such a contention would be wholly meritless. Nothing in the record in this case suggests that the Board's determination that such investment management activities are closely related to banking is arbitrary or capricious. Banks have traditionally organized and administered large collective investment funds such as common trust funds and pooled employee benefit funds through their trust departments. In addition, available statistics demonstrate that commercial banks and trust companies have for many years sponsored, organized, and managed closed-end investment companies.

Because Congress intended to delegate to the Board the decision whether a particular activity is "closely related" to banking (S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955)), and because the Board's judgment on this essentially factual question is entitled to judicial deference, the Board's determination under Section 4(c)(8) that organization and management of a closed-end investment company is an appropriate fiduciary function for a bank holding company should be upheld.

ARGUMENT

ORGANIZATION AND MANAGEMENT OF A CLOSED-END INVESTMENT COMPANY ARE ACTIVITIES PERMISSIBLE FOR A BANK HOLDING COMPANY UNDER SECTION 20 OF THE GLASS-STEAGALL ACT AND SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT

By enacting Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), Congress determined that bank holding companies may engage in certain business activities distinct from banking, provided that the Federal Reserve Board finds that those activities are so closely related to banking as to be a proper incident thereto. The statute does not specify any activities that the Board must approve as closely related to banking, and it does not forbid any activities. However, Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, limits the activities of bank affiliates, including bank holding companies and companies under common control with banks, and provides that such affiliates shall not engage "principally" in the issuance, flotation, underwriting, public sale or distribution of securities. Thus, Section 20 places an outer limit on the scope of activities that may be authorized under Section 4(c)(8) of the Bank Holding Company Act.

In authorizing bank holding companies to organize and manage closed-end investment companies within carefully prescribed restrictions, the Federal Reserve Board applied these statutes according to their plain meaning. The Board found both that the authorized activities were within the limits of the Glass-Steagall Act and were closely related to traditional banking

services as required under the Bank Holding Company Act. In setting aside the Board's regulation and interpretive ruling, the court of appeals did not disagree with the Board's analysis of the Glass-Steagall Act. Rather, the court read into the Bank Holding Company Act an implied prohibition against "securities activities" by bank holding companies. The court concluded that Congress believed that the Glass-Steagall Act prohibited a bank holding company to provide investment management services to closed-end investment companies when the Bank Holding Company Act was enacted, even though that belief "may have been mistaken" (Pet. App. 24a-25a, 28a-29a, 42a-44a).

In reaching its decision, the court of appeals failed to adhere to the literal text of the relevant statutes and misconstrued the legislative history. The statutes and their history show that Congress intended to empower the Board to authorize activities that are closely related to banking if those activities do not result in bank holding companies' becoming principally engaged in the issuance or distribution of securities. Application of these standards confirms that the Board properly authorized bank holding companies to organize and manage closed-end investment companies within the limitations prescribed in its regulation and interpretive ruling.

In the pages below, we first demonstrate that the investment management activities approved by the Board are consistent with the provisions of the Glass-Steagall Act. We then show that they are consistent with the provisions of the Bank Holding Company Act.

I. THE GLASS-STEAGALL ACT PERMITS BANK HOLDING COMPANIES TO ORGANIZE AND MANAGE CLOSED-END INVESTMENT COMPANIES WITHIN THE LIMITATIONS PRESCRIBED BY THE BOARD

In issuing its regulation and interpretive ruling, the Board acknowledged that the Glass-Steagall Act applies to bank holding companies serving as investment managers. It nonetheless determined that the Glass-Steagall Act does not prevent a bank holding company from serving in that capacity for a closed-end investment company subject to the limitations that the Board prescribed in its interpretive ruling. 12 C.F.R. 225.125.[10] That determination, undisturbed by the court of appeals, is correct.

A. The Glass-Steagall Act forbids affiliates of banks to engage "principally" in the issuance or distribution of securities

In addressing the requirements of the Glass-Steagal Act, the starting point must be the language of the statute itself. See, *e.g.*, *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, No. 77-1645 (Nov. 13, 1979), slip op. 4. As both the Board and court of appeals recognized, Congress enacted several provisions in the Glass-Steagall Act that prescribe distinct and separate standards (Pet. App. 54a-55a; 17a-21a). In particular, Congress prescribed different rules for banks and bank affiliates, such as bank holding com-

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[10] The Board explained, however, that organization and management of an *open-end* investment company (mutual fund) is forbidden under the Glass-Steagall Act. 12 C.F.R. 225.125(f).

panies and companies under common control with banks.

Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, provides that national banks may not underwrite any issue of securities or stock. Section 16 also provides that national banks may buy and sell certain categories of securities only for the account of customers and not for their own account.[11] In addition, Section 21 of the Glass-Steagall Act, 12 U.S.C. 378, forbids organizations engaged in the business of issuing, underwriting, selling, or distributing securities to engage in the business of receiving deposits—the business of banking. Where applicable, Sections 16 and 21 impose an unqualified prohibition. See *Investment Company Institute* v. *Camp*, 401 U.S. 617, 624-625, 639 (1971).

The Glass-Steagall Act prescribes less stringent rules for organizations that are "affiliated" with commercial banks. As originally enacted, the Glass-Steagall Act contained a provision specifically regulating affiliates that were bank holding companies. In Section 19(e) of the Act, 12 U.S.C. (1964 ed.) 61 (e), Congress provided that a bank holding company could not vote the shares of a bank subsidiary without a permit from the Board and that a permit would not be granted unless the holding company agreed to divest itself within five years of its controlling interest in any company formed for the pur-

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[11] State banks that are members of the Federal Reserve System are subject to the same restrictions that apply to national banks. 12 U.S.C. 335.

pose of or "engaged principally in" the issuance or underwriting of securities.[12] Similarly, Sections 2(b)(2) and 20 of the Act, 12 U.S.C. (1964 ed.) 221a(b)(2) and 377, provided that a member bank could not be under common control with a corporation "engaged principally" in the issuance or underwriting of securities.[13]

In 1966, Congress repealed the bank holding company provision contained in Section 19(e). See 80 Stat. 242-243; *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243-244 (1978). At the same time, Congress enlarged the coverage of Section 20 by amending the definition of "affiliate" in Section 2(b) of the Act to include bank holding companies. See 80 Stat. 242 (12 U.S.C. 221a(b)(4)). As a result of the repeal of Section 19(e) and the enlargement of the coverage of Section 20, the voting permit procedure was superseded and bank holding companies became subject to the prohibition in Section 20 against engaging "principally" in the issuance or underwriting of securities.

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[12] Section 19(e) did not prohibit bank holding companies to own investment banking subsidiaries. Rather, the statute provided that permission to vote the shares of a national bank subsidiary was contingent on the holding company's divestiture within five years of its interest in investment banking firms.

[13] As originally enacted, Sections 2(b)(2) and 20 covered various kinds of non-holding company affiliates. 48 Stat. 162, 188. See also Section 32 of the Act, 12 U.S.C. 78, barring, *inter alia*, interlocking directorates between banks and business firms "primarily engaged" in the issuance or underwriting of securities.

Both Section 20 and its predecessor, Section 19(e), utilize the "engaged principally" standard. In contrast to the provisions applicable to banks (Sections 16 and 21), the provisions regulating bank affiliates do not prescribe an unqualified prohibition against underwriting or distributing securities. As this Court has recognized, the difference in strictness of the standards prescribed in the several provisions of the Glass-Steagall Act was deliberate. See *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 447-448 (1947):

> Section 20 of the Act outlaws affiliation of a member bank with an organization "engaged principally" in the underwriting business. Section 19 provides control over bank holding companies. In order to vote its stock in controlled banks a bank holding company must show that it does not own, control or have any interest in, and is not participating in the management or direction of any organization "engaged principally" in the underwriting business. On the other hand, when Congress came to deal with the practice of underwriters taking checking deposits, it used language different from what it used in §§ 19 and 20 * * *. By § 21 it prohibited any organization "engaged" in the underwriting business "to engage at the same time to any exent whatever" in the business of receiving checking deposits. Thus within the same Act we find Congress dealing with several types of underwriting firms—those "engaged" in underwriting, those "primarily engaged" in underwriting, those "engaged principally" in under-

> writing. The inference seems reasonable to us that Congress by the words it chose marked a distinction which we should not obliterate * * *.

As the statutory pattern summarized above demonstrates, the provisions of the Glass-Steagall Act applicable to bank affiliates (including bank holding companies and companies subject to common control with banks) are Section 20 of the Act, and its predecessor, Section 19(e).[14] The test that Congress has prescribed under those provisions is whether a bank affiliate is "engaged principally"—as opposed to incidentally—in the issuance or distribution of securities.[15]

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[14] The Board consistently has held that Section 20 governs the securities activities of bank holding companies and their non-bank subsidiaries. See 12 C.F.R. 250.221; *Financial Services Corporation of the Midwest*, 63 Fed. Res. Bull. 948 & n.2 (1977).

[15] In light of the statutory pattern summarized above, both the Board and the court of appeals correctly determined that respondent's challenge to the Board's regulation and interpretive ruling based on Sections 16 and 21 of the Glass-Steagall Act is without merit. Section 21 of the Glass-Steagall Act, 12 U.S.C. 378, forbids a corporation to engage in both the business of underwriting and the business of receiving deposits (commercial banking). As the Board noted, the literal language of this provision shows that it is inapplicable to a bank holding company or a non-banking subsidiary that does *not* receive deposits (Pet. App. 54a-56a). The court of appeals agreed, explaining that "Congress, in the Glass-Steagall Act, did indeed intend to regulate the activities of bank holding companies and their non-bank subsidiaries—but *not* in Section 21 of the Act" (Pet. App. 20a-21a). Likewise,

B. A closed-end investment company that issues its shares only when it commences business and on infrequent occasions thereafter is not "engaged principally" in the issuance or distribution of securities

Under the Board's regulation and interpretive ruling, a bank holding company (and its non-bank subsidiaries) are authorized to "control" a closed-end investment company. Even if such an investment company is deemed to be a bank "affiliate" by reason of that control,[16] the closed-end investment company does not engage "principally" in the issuance or distribution of securities in violation of Section 20 of the Glass-Steagall Act.[17]

As the court of appeals correctly pointed out, a closed-end investment company "typically does not issue shares after its initial offering except at infrequent intervals, and does not stand ready to redeem them" (Pet. App. 6a). A closed-end investment company is no more engaged in the issuance or distribu-

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Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, applies, by its terms, only to banks. As the Board pointed out, the challenged regulation and interpretive ruling only authorize fiduciary activities by bank holding companies, not banks (Pet. App. 60a-61a). The court of appeals concurred in that interpretation (Pet. App. 21a-23a).

[16] We assume, arguendo, that under some circumstances a closed-end investment company managed by a bank holding company could be deemed a bank "affiliate." See 12 U.S.C. 221a(b)(2); but see note 7, *supra*.

[17] The word "principal" means "chief," "main" or "important." See *Webster's New International Dictionary* 1966 (1936); *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 446.

tion of securities than is any publicly held corporation.[18] As explained by the Securities and Exchange Commission in its *Report On The Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 42-43 (1966) ("Report on Public Policy Implications"):

> Since a closed-end company is under no obligation to redeem, that is, buy back its own shares, its capital structure is much like that of companies in other areas of the economy. Equity capital contributed by the public is viewed as permanently committed to the enterprise * * * * * * * * *. [C]losed-end companies do not continuously issue new shares; and since the tendency of their shares to sell at a discount from net asset value normally precludes them from publicly offering new shares, infusions of new capital are rare.

Accord, *SEC Report on Investment Trusts and Investment Companies* (Part 1), H.R. Doc. No. 707, 75th Cong., 3d Sess. 26-27 (1938) ("Report On Investment Trusts"); see also Pet. App. 84a; Section 5(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(a). Thus, the principal activity of a closed-end investment company is to invest and re-

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[18] Closed-end investment companies, issuing their shares when organized and on infrequent occasions thereafter, are similar to ordinary corporations that "go public." Banks and bank holding companies, of course, issue their own securities when they are organized. See, *e.g.*, 12 U.S.C. 51 *et seq.* No one has ever suggested that the securities activity involved in an initial capitalization infringes any provision of the Glass-Steagall Act.

invest the assets that have been "permanently contributed to the enterprise."

Because closed-end investment companies, in contrast to open-end investment companies (mutual funds), do not continuously issue and sell their own securities, but instead generate capital through a single offering of non-redeemable securities when the company commences business, the Board repeatedly has determined that closed-end investment companies are not "primarily engaged" in the issuance or distribution of securities. See 25 Fed. Reg. 3464 (1960), 12 C.F.R. 218.102; 26 Fed. Reg. 868-869 (1961), 12 C.F.R. 218.104(d).[19] It follows a fortiori that they are not "principally engaged" in the issuance or distribution of securities within the meaning of Section 20 of the Glass-Steagall Act. See

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[19] Open-end investment companies, in contrast to closed-end companies, engage in a continuous process of redeeming and issuing their shares. See *United States* v. *National Association of Securities Dealers*, 422 U.S. 694, 698 (1975): "In order to avoid liquidation through redemption, mutual funds continuously issue and sell new shares. These features—continuous and unlimited distribution and compulsory redemption—are, as the Court recently recognized, 'unique characteristics' of this form of investment." See also *id.* at 698 n.2.

Because open-end investment companies issue their shares continuously to offset redemptions and to prevent contraction of their assets, the Board has determined that they are "primarily engaged" in the issuance and sale of securities. See 16 Fed. Reg. 4963 (1951), 12 C.F.R. 218.101. Consistent with this interpretation, the Board prescribed in its interpretive ruling here that a bank holding company may not organize or manage an open-end investment company. See 12 C.F.R. 225.125(f).

Board of Governors of the Federal Reserve System v. *Agnew*, *supra*, 329 U.S. at 446-449 ("principal" engagement in issuance or distribution of securities may be somewhat greater than "primary" engagement); Pet. App. 77a.

The Board's regulation puts to rest any doubt on this question by allowing bank holding companies and their non-bank subsidiaries to organize and manage *only* those investment companies that "are not primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. 225.125 (f).[20]

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[20] In some instances, there may be overlapping employment relationships or interlocking directors between an investment company and a subsidiary bank of a bank holding company investment adviser. Under Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, such interlocks are forbidden if the investment company engages "primarily" in the issuance or distribution of securities. As previously noted, the Board consistently has determined that *closed-end* investment companies are not engaged "primarily" in the issuance or distribution of securities. The Board's regulation and ruling here expressly forbid affiliation with any investment company that engages primarily or frequently in the sale or distribution of securities. Thus, an overlapping director or employment relation between a bank and a closed-end investment company could not violate Section 32 of the Glass-Steagall Act.

That conclusion is reinforced by Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. 80a-10(c), which regulates director interlocks between banks and investment companies. This statutory provision clearly demonstrates that Congress did not intend to foreclose director interlocks

C. A bank holding company that organizes and manages a closed-end investment company within the limitations prescribed by the Board is not "engaged principally" in the issuance or distribution of securities

A bank holding company (or a non-bank subsidiary of the holding company) that controls a subsidiary bank is a bank "affiliate" subject to the restrictions of Section 20 of the Glass-Steagall Act. See 12 U.S.C. 221a(b), 377, 1841(a). Section 20 therefore requires that such a bank holding company not engage "principally" in the issuance or distribution of securities. The Board's regulation and interpretive ruling prescribe a code of restrictions to assure that the fiduciary function of managing a closed-end investment company does not result in a bank holding company's becoming engaged principally, if at all, in the issuance or distribution of securities. 12 C.F.R. 225.125. Under the Board's regulation and interpretive ruling, any connection between the bank holding company and the issuance or distribution of the securities of its investment company advisee is remote and incidental.[21]

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between banks and *all* investment companies. While a director interlock with an open-end investment company would be prohibited by Section 32 of the Glass-Steagall Act, Section 32 and Section 10(c) of the Investment Company Act permit interlocks (subject to regulatory requirements) between banks and closed-end investment companies.

[21] Investment advisers typically organize, manage, and provide miscellaneous services to their client investment companies. See *Burks* v. *Lasker*, 441 U.S. 471, 480-481 (1979). See also *Wharton School Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. 476-477 (1962); *SEC Insti-*

In organizing and managing a closed-end investment company, a bank holding company does not itself "issue" securities.[22] Moreover, under the Board's regulation and interpretive ruling, bank holding companies are permitted to manage only closed-end investment companies. See 12 C.F.R. 225.125(f). Because a closed-end investment company issues shares only infrequently, organization and management of such an entity could not cause its adviser to become "principally engaged" in the business of issuing securities. The principal function of a bank holding company managing a closed-end investment company is to invest and reinvest the assets that initially have been contributed to the closed-end investment company.

Nor does the bank holding company investment adviser engage principally, if at all, in the "flotation, underwriting, public sale, or distribution" of securi-

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tutional Investor Study Report, H.R. Doc. No. 92-64 (Part 2), 92d Cong., 1st Sess. 167-168, 207-208 (1971). Under the Board's regulation and interpretive ruling, a bank holding company (or its non-bank subsidiary) would be free to organize and manage the client investment company, to select its investments, and to provide ancillary services including custodial and clerical assistance. See 12 C.F.R. 225.125(i).

[22] The securities issued by a closed-end investment company are, of course, the securities of that company, not the securities of the investment adviser. The investment company is the entity that "issues or proposes to issue any security" (see Section 2(4) of the Securities Act of 1933, 15 U.S.C. 77b(4); Section 2(a)(22) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(22))—*i.e.*, the entity that creates the rights and obligations evidenced by the security.

ties. To assure that bank holding companies engage principally in the fiduciary activity of investment management, rather than the underwriting of securities, the Board has prescribed that bank holding companies may not "directly or indirectly" sell or distribute the shares of investment companies. 12 C.F.R. 225.125(h). That underwriting task must be performed solely by a distributor or investment banker unaffiliated with the bank holding company. The Board's interpretive ruling also provides that "[p]rospectuses or sales literature should not be distributed by the holding company, nor should any literature be made available to the public at any offices of the holding company." *Ibid.* Thus, even with respect to closed-end investment companies that issue securities only on an infrequent basis, the Board's regulation completely divorces the bank holding company from the process by which securities are disseminated. This segregation of the underwriting and investment management functions assures that the services performed by the bank holding company are "principally" fiduciary services, not investment banking services in violation of Section 20 of the Glass-Steagall Act.[23]

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[23] Throughout its opinion, the court of appeals intimates that management of a closed-end investment company is somehow similar to engaging in "investment banking" (Pet. App. 29a & n.32, 30a). The court does not explain, however, how managing a closed-end investment company within the restrictions prescribed by the Board is akin to the business of investment bankers who purchase and resell the securities of corporate issuers or assist in the distribution and promotion

D. The Board's regulation and interpretive ruling prescribe safeguards to prevent conflicts of interest and unsound banking practices of the kind that concerned Congress when the Glass-Steagall Act was enacted

This Court's decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), reviews the legislative history of the Glass-Steagall Act and summarizes the concerns that led to the enactment of that statute. The holding in *Camp* is not directly relevant here, since the Court there construed Sections 16 and 21 of the Glass-Steagall Act—provisions that apply to banks—and did not rule on the scope of the different provisions that apply to bank "affiliates." As previously noted, the provisions of the Glass-Steagall Act applicable to affiliates are less stringent than those applicable to banks. See *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 447-448.[24]

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of those securities. The business of investment banking consists in channeling new offerings to the investing public, not in managing the portfolio of an investment company advisee for an annual fee. See I L. Loss, *Securities Regulation* 159-178 (1961). In short, management of a closed-end investment company does not give rise to the "needs and interests" of investment banking. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 637. The court of appeals compounds the semantic confusion by referring repeatedly to "the abuses stemming from bank involvement in the *securities* business" (Pet. App. 39a) (emphasis in original). However, as the literal text of the Glass-Steagall Act makes clear, Congress did not intend to prohibit purchasing and selling securities in a fiduciary capacity for the account of customers. See Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh; H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935); 12 U.S.C. 92a.

[24] We also note that the activities authorized for bank holding companies by the Board's regulation and ruling are fun-

Nonetheless, in promulgating its regulation and interpretive ruling, the Board was sensitive to the policy concerns that the Glass-Steagall Act embodies, as summarized by this Court in the *Camp* decision. See Pet. App. 83a-85a. The restrictions contained in the Board's interpretive ruling were specifically formulated to prevent conflicts of interest and unsound banking practices of the kind discussed in *Camp*.

The overriding purpose of the Glass-Steagall Act is to safeguard banks from losses and risks attendant upon participation in the speculative business of investment banking. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629-630.[25] Under the Board's regulation and interpretive ruling, that danger is entirely avoided. The Board's ruling prohibits bank holding companies (and their bank and

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damentally different from those performed by the bank in the *Camp* case. In *Camp*, the bank was the underwriter of the fund's shares, the fund issued redeemable shares and thus re issued its shares continuously, the fund was made available principally to customers of the bank and was held out as a service of the bank, and the fund bore the name of the bank. 401 U.S. at 622-626 & n.12. Under the Board's regulation and ruling, none of these activities or relationships is permissible.

[25] Congress enacted the Glass-Steagall Act during a period of unprecedented bank failures. Between 1921 and 1929, approximately 5,700 banks became insolvent. See Lehr, *The Affiliation of Commercial Bank and Mutual Fund Personnel (Part I)*, 83 Banking L.J. 377, 384 (1966); S. Rep. No. 77, 73d Cong., 1st Sess. 8, 10 (1933); 75 Cong. Rec. 9910 (1932) (remarks of Sen. Bulkley); *Russell* v. *Continental Illinois National Bank & Trust Co.*, 479 F.2d 131, 133-134 (7th Cir. 1973).

non-bank subsidiaries) from purchasing interests in or lending money to an advisee investment company. 12 C.F.R. 225.125(g). Thus, the capital of banks and their affiliates is not placed at risk through investments in or loans to the investment company. See *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630, 638.[26]

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[26] When it enacted the Glass-Steagall Act, Congress expressed concern over the risks created by "securities affiliates." *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629; 77 Cong. Rec. 3725 (1933) (remarks of Sen. Glass); S. Rep. No. 77, *supra*, at 10. Those affiliates engaged in "perilous underwriting operations, stock speculation, and maintaining a market for the bank's own stock often largely with the resources of the parent bank." *Ibid.*; see also 75 Cong. Rec. 9909-9913 (1932) (remarks of Sen. Bulkley); 75 Cong. Rec. 9887 (1932) (remarks of Sen. Glass); *Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency* (Part VII), 71st Cong., 3d Sess. 999-1001, 1052-1068 (1931). As this Court noted in *Camp*, securities affiliates operated to a significant extent with funds borrowed from their parent banks. 401 U.S. at 631 n.31. Those securities affiliates bear no resemblance to the closed-end investment companies covered by the Board's regulation and ruling. The securities affiliates described by Congress were merely vehicles for investing the bank's own funds in speculative securities, for channeling the funds of bank shareholders into speculation, or for engaging in wholesale or retail investment banking. Thus, contrary to the suggestions of the court of appeals (Pet. App. 26a-28a), the legislative history contains no indication that Congress intended to foreclose the limited fiduciary services at issue in this case.

We also note that the court of appeals draws unwarranted inferences from the legislative history that cannot be squared with the legislation that was actually enacted by Congress. Thus, the court infers that the purpose of the Glass-Steagall Act was to separate as far as possible national and member banks "from affiliates of all kinds" (Pet. App. 29a). However, as discussed on pages 19-23, *supra*, Congress dealt with the

The Board's interpretive ruling imposes additional restrictions to eliminate "the more subtle hazards" that the Glass-Steagall Act sought to avoid. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630. As noted in *Camp*, unsound banking practices may result when a bank operates a mutual fund, which requires it to engage in the business of aggressively marketing securities. 401 U.S. at 631, 632-633, 637-638. The Board's regulation and interpretive ruling eliminate this promotional pressure. As previously noted, a closed-end investment company does not issue redeemable shares and is not continuously engaged in the offer and sale of securities. A closed-end investment company does not face the prospect of liquidating its assets or selling new shares to cover redemptions. Operation of a closed-end investment company does not require the manager to serve as the functional equivalent of an investment banker or underwriter. See 401 U.S. at 632-636.[27] Thus, a

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abuses that it found to exist through statutory provisions prescribing specific rules. Those provisions do not forbid *all* affiliates. Affiliates not engaged "principally" or "primarily" in issuing or underwriting securities were not divorced from banks. Moreover, contrary to the conclusion of the court of appeals (Pet. App. 28a n.30), banking organizations have continued to sponsor and organize closed-end investment companies following the enactment of the Glass-Steagall Act. See *SEC Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 58, 124 (Table 25) (1939). See also pages 53-56, *infra*.

[27] The stable capital base of a closed-end investment company has been noted in studies of investment companies:

> Equity capital contributed by the public is viewed as permanently committed to the enterprise * * *. The

bank holding company that manages a closed-end investment company has no "particular investment to sell." *Id.* at 636. The manager does not stand to gain from resales of shares of a closed-end investment company that may occur between brokers or dealers or on the open market. There is no incentive for the bank holding company to promote continuously the sale of the closed-end investment company's shares.[28]

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company is not engaged in a continuous quest for new equity capital.

Public Policy Implications Of Investment Company Growth, supra, at 42. Investment advisers serving investment companies receive a fee that is generally a fixed percentage of the value of the assets under management. *Id.* at 8, 42. In the case of closed-end investment companies, that fee increases only through an increase in the value of the company's investment portfolio—not (as in the case of an open-end investment company) through the sale of additional shares. See *SEC Report of Special Study of Securities Markets,* H.R. Doc. No. 95 (Part 4), 88th Cong., 1st Sess. 204-205, 96-99 (1963).

[28] Respondent has acknowledged the absence of promotional pressures in managing closed-end investment companies (Hearings before the Board of Governors of the Federal Reserve System, Nov. 12, 1971, Tr. 15, testimony of G. Duane Vieth):

> In our judgment, the most serious of those conflicts of interest relate to this promotional aspect, this concern by the bank or its affiliates in constantly selling the shares, and that, as I say, is not typical of a closed-end company. So, I would have to be frank to say to you that the serious conflicts that we see are not present with respect to closed-end companies.

Moreover, even if there were such an incentive, promotional and underwriting activities of any kind are flatly forbidden under the Board's interpretive ruling.

The Board's interpretive ruling also eliminates practices that could impair the public's attitude toward the holding company and its bank subsidiaries. Thus, to avoid injury to a holding company's reputation that could result from poor performance of its advisee's investment portfolio (401 U.S. at 631), the Board has prohibited bank holding companies from serving as advisers to investment companies with names similar to those of the holding company or any of its subsidiary banks. 12 C.F.R. 225.125(f). And to avoid the possibility that depositors might lose confidence in the holding company or its subsidiary banks (401 U.S. at 631), the Board has prohibited bank holding companies from distributing sales literature concerning investment company advisees. Likewise, the names of bank customers may not be furnished to distributors or underwriters who sell shares of advisee investment companies. 12 C.F.R. 225.125 (h).

Finally, to avoid the possibility that advising an investment company may conflict with "the obligation of the commercial banker to provide disinterested investment advice" (401 U.S. at 633, 636-637), the Board also has forbidden bank holding companies and their subsidiaries to exercise fiduciary powers to purchase securities of advisee investment companies. 12 C.F.R. 225.125(g). Similarly, the Board has forbid-

den the employees of subsidiary banks from expressing any opinion with respect to the shares of the advisee. 12 C.F.R. 225.125(h). And to reduce the likelihood that a subsidiary bank might extend credit "to facilitate the purchase of interests" in the investment company advisee (401 U.S. at 638), the interpretive ruling forbids bank holding companies and their subsidiaries from accepting the securities of advisees as collateral for loans to purchase such securities. 12 C.F.R. 225.125(g).[29]

E. The Board's determination that bank holding companies may manage closed-end investment companies without infringing the Glass-Steagall Act is entitled to judicial deference

The Board's conclusion that a bank holding company—operating within the limitations prescribed in its regulation and interpretive ruling—may manage a closed-end investment company without infringing

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[29] Of course, many services offered by banks involve promotional activity. For example, banks aggressively promote their traditional trust services. See, *e.g.*, W. Kennedy and P. Searle, *The Management of a Trust Department* 83-119 (1967); *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 644 (Blackmun, J., dissenting). The existence of promotional activity, by itself, does not give rise to Glass-Steagall Act violations, so long as the banking organization is effectively segregated from the underwriting process and the issuance of securities is infrequent. Thus, the actions of a bank holding company engaged in organizing and managing an investment company within the strictures prescribed by the Board do not amount to forbidden promotion of investments—"In short there is a plain difference between the sale of fiduciary services and the sale of investments." *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 638.

the Glass-Steagall Act is entitled to judicial deference. The Board is one of the government agencies primarily responsible for enforcing the Glass-Steagall Act.[30] The Board's experience in enforcing the Act and in determining what safeguards are required to protect the public interest justifies invocation of the general principle that "considerable respect is due the 'interpretation given [a] * * * statute by the officers or agency charged with its administration.'" *Ford Motor Credit Co.* v. *Milhollin*, No. 78-1487 (Feb. 20, 1980), slip op. 10. As Justices Rutledge and Frankfurter explained in their concurring opinion in *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 450 (construing the Glass-Steagall Act): "Not only because Congress has committed the system's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated judgment in all its phases, I think their judgment should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion." This Court repeatedly has applied that rule in upholding the Board's statutory interpretations and in sustaining its regulations. See, *e.g.*, *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978) ("[C]ourts should defer to an agency's construction of its own statutory mandate"); *Mourning* v. *Family*

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[30] The Board is empowered to assess substantial civil penalties for violations of Section 20. See 12 U.S.C. 377.

Publications Service, Inc., 411 U.S. 356, 369 (1973) ("the validity of a regulation * * * will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation' ").

These principles apply here and require affirmance of the Board's determination that a bank holding company, acting within the restrictions prescribed by the Board, may be permitted to organize and manage a closed-end investment company without infringing the Glass-Steagall Act.

II. SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT OF 1956 EMPOWERS THE BOARD TO DETERMINE THAT ORGANIZATION AND MANAGEMENT OF A CLOSED-END INVESTMENT COMPANY ARE ACTIVITIES CLOSELY RELATED TO BANKING AND THUS ARE PERMISSIBLE FOR A BANK HOLDING COMPANY

Although the court of appeals rejected respondent's contention that the Glass-Steagall Act forbids bank holding companies to manage closed-end investment companies, it nonetheless reached the conclusion that the Board may not authorize such activities under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). In so holding, however, the court of appeals disregarded the plain meaning of Section 4(c)(8), which delegates to the Board discretionary authority to determine which activities are closely related to banking and thus are permissible for bank holding companies. The court likewise overlooked the structure of the Act and misconstrued the legislative history.

A. Section 4(c)(8) vests in the Board authority to determine which activities are "closely related" to banking

Section 4(c)(8) authorizes bank holding companies to acquire shares of any company the activities of which "the Board * * * has determined * * * (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." [31] By its terms, Section 4(c)(8) neither authorizes nor prohibits particular business activities. The statute delegates the task of delineating permissible non-banking activities to the Board, the expert agency.[32]

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[31] Section 4(c)(8) is one of several exemptions from the general prohibition contained in Section 4(a) of the Bank Holding Company Act, 12 U.S.C. 1843(a), which forbids a bank holding company to acquire shares of any company that is not engaged in the activity of banking. Under Section 4(a)(2) of the Act, 12 U.S.C. 1843(a)(2), a bank holding company may not engage "in any activities other than (A) those of banking or of managing or controlling banks * * * (B) those permitted under paragraph (8) of subsection (c) of this section * * *." In addition to Section 4(c)(8), other provisions of the Bank Holding Company Act permit bank holding companies to engage in activities beyond those of banking and managing banks. See, *e.g.*, Sections 4(c)(6) and 4(c)(7), 12 U.S.C. 1843(c)(6), (7), which permit bank holding companies to purchase, within limits, equity securities for their own account—activities plainly impermissible for banks.

[32] See *National Courier Ass'n* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1237 (D.C. Cir. 1975); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, 568 F.2d 549, 551-552 (7th Cir. 1978).

On its face, Section 4(c)(8) does not exclude securities-related activities from the realm of activities that are closely related to banking. And since Congress has long authorized national banks to serve in various fiduciary capacities involving securities (see 12 U.S.C. 92a; 12 U.S.C. 24 Seventh), no such limitation can logically be implied. Commercial banks today are the nation's largest portfolio managers. See *SEC Institutional Investor Study Report, supra,* at 413-494. At the end of 1978, trust departments of insured commercial banks managed over $441.8 billion in assets. *American Banker,* Nov. 16, 1979 at 1, col. 1. Bank trust departments administer common trust funds, employee benefit trusts, institutional and corporate agency accounts, as well as personal trust and agency accounts. See *SEC Institutional Investor Study Report, supra*; see also 12 C.F.R. 9.18 (prescribing rules for collective investment funds managed by national bank trust departments). In short, discretionary investment management services "ha[ve] been a traditional banking function as long as there have been banks" (Pet. App. 57a).[33]

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[33] As the American Bankers Association stated in its comment on the Board's proposed rule: "The fact that this type of activity is closely related to banking and is consistent with the traditional role of banks in serving fiduciary customers is clearly evidenced. For well over a century, banks and trust companies in every state have managed and administered customers' investment funds * * *" (A. 20). The close connection between the activities authorized by the Board's regulation and traditional banking services is discussed further on pages 53-56, *infra.*

The structure of the Bank Holding Company Act reinforces the conclusion that Congress did not intend to forbid a bank holding company to manage a closed-end investment company. Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), expressly permits bank holding companies to acquire and own the shares of investment companies.[34] Since a bank holding company is empowered to manage, control, and provide services to all of its subsidiaries,[35] a bank holding company clearly may manage, control, and advise a subsidiary investment company. Moreover, because the language of Section 4(c)(7) permits a bank holding company to acquire any or all of the shares of an investment company, it follows that a bank holding company may manage an investment company in which other investors have an interest.[36] In light of this express authorization to own, control, and manage an investment company subsidiary,

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[34] The statute imposes certain limitations, not relevant here, on the type of investment company shares that may be acquired by a bank holding company. The investment company may not be a bank holding company, may not engage in any business other than investing in securities, and may not hold more than 5% of the shares of any corporation. 12 U.S.C. 1843(c)(7).

[35] See 12 U.S.C. 1843(a)(2)(A).

[36] While Congress was evidently considering the case of a wholly owned investment company when it enacted Section 4(c)(7) (see 102 Cong. Rec. 6851-6854 (1956)), the language of the provision is not so limited. Supporters of the provision repeatedly acknowledged that it would apply to any investment company meeting the statutory criteria. See 102 Cong. Rec. 6852 (1956) (remarks of Sen. Barkley).

it is illogical to contend that Congress believed that rendering management services to an investment company is an inappropriate activity for a bank holding company under the flexible standard of Section 4(c)(8).

B. The legislative history of Section 4(c)(8) shows that Congress intended to vest discretion in the Board to authorize business activities closely related to banking that are not forbidden by the Glass-Steagall Act

The legislative history of Section 4(c)(8) confirms that Congress intended the Board to exercise its expert judgment in designating activities that are closely related to banking and did not mean to proscribe securities-related activities other than those expressly forbidden by the Glass-Steagall Act. Nothing in the legislative history supports the view of the court of appeals that Congress believed that organization and management of a closed-end investment company are impermissible activities for a bank holding company.[37]

1. The Bank Holding Company Act, ch. 240, 70 Stat. 133, as originally enacted in 1956, provided in Section 4(c)(6) (the predecessor of Section 4(c)(8)), that bank holding companies may acquire:

> shares of any company * * * the activities of which are of a financial, fiduciary, or insurance

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[37] This Court reviewed the legislative history of the Bank Holding Company Act in *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp., supra,* 439 U.S. at 243-247.

> nature and which the Board * * * has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto * * *.

70 Stat. 137. Like the current Section 4(c)(8), Section 4(c)(6) delegated to the Board the task of delineating permissible activities. As the Senate Report explained (S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955)):

> In the opinion of your committee, certain activities of a financial, fiduciary, or insurance nature are obviously so closely related to banking as to require no divestment by a bank holding company. * * * [T]here are many * * * activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity. For this reason your committee deems it advisable to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits.

Congress' awareness of the fact that the Board could lawfully authorize bank holding company activities involving securities is evident from the fact that Section 4(c)(6) extended to "financial" or "fiduciary" services.

Congress intended the Bank Holding Company Act of 1956 to remedy inadequacies in prior holding company legislation, *i.e.*, Section 19 of the Glass-Steagall

Act (12 U.S.C. (1964 ed.) 61). See *Board of Governors of Federal Reserve System* v. *First Lincolnwood Corp.*, *supra*, 439 U.S. at 243-244. (Section 19 is discussed on pages 20-21, *supra*). The 1956 legislation strengthened the Board's regulatory authority over bank holding companies, but there is no suggestion that Congress believed that operation of a closed-end investment company was improper under the Glass-Steagall Act or should be forbidden under the Bank Holding Company Act.[38]

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[38] The major premise on which the court of appeals rests its analysis of the Bank Holding Company Act is the assertion that the 1956 legislation was not "broad" enough to embrace management of a "closed-end investment company" (Pet. App. 30a). However, the court cites nothing in the text or history of the Act which supports that assertion. Instead, the court invokes the "over-arching policy" of the Glass-Steagall Act "of divorcing investment from commercial banking" (*ibid.*). However, as we have previously demonstrated, management of a closed-end investment company within the limitations prescribed by the Board is not "investment banking." Moreover, the divorce between investment and commercial banking that is relevant in the case of bank affiliates is prescribed by Section 20 of the Glass-Steagall Act—a provision that only forbids bank affiliates to become "principally" engaged in issuing or underwriting securities. That provision does not prevent a bank holding company from managing a closed-end investment company that issues shares only infrequently. In sum, the court of appeals imputes to the Glass-Steagall Act a prohibition that it does not contain. Nor is there any basis for the court of appeals' inference (Pet. App. 44a) that Congress "may have been mistaken" about the meaning of the terms of the Glass-Steagall Act when it enacted the Bank Holding Company Act. The court of appeals cites no evidence that Congress misapprehended the plain meaning of the statutory provisions that it had previously enacted—provisions that this Court had authorita-

2. The 1966 amendments to the Bank Holding Company Act did not alter the Board's mandate to authorize activities closely related to the business of banking.[39] The only change resulting from the 1966 legislation that is relevant for present purposes is Congress' repeal of Section 19(e) of the Glass-Steagall Act and its abandonment of the voting permit procedure.[40] See 80 Stat. 242-243. As noted on page 21, *supra*, at the time that Congress repealed Section 19(e) of the Glass-Steagall Act, it simultaneously enlarged the coverage of Section 20 of the Glass-Steagall Act to make that provision applicable to bank holding companies.[41] Thus, the standard of securities-relatedness that Congress contemplated would apply to bank holding companies when it amended the Bank Holding Company Act in 1966 is the standard expressed in Section 20—that such bank

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tively construed in 1947 in *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*. See also *Barrett* v. *United States*, 423 U.S. 212, 217 (1976).

[39] In 1966, Section 4(c)(6) was renumbered Section 4(c)(8) without substantive change. See 80 Stat. 239.

[40] Section 19(e) was a largely ineffective provision. A bank holding company could escape regulation entirely simply by declining to vote its shares in the subsidiary bank. See S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955); S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966).

[41] Congress enlarged the coverage of Section 20 by amending the definition of "affiliate" contained in 12 U.S.C. 221a(b). See 80 Stat. 242; page 21, *supra*. Prior to 1966, Section 20 did not apply to bank holding companies. Section 20 applied only to entities under common control with member banks and direct subsidiaries of banks. See 48 Stat. 162-163.

affiliates may not engage "principally" in the issuance or underwriting of securities. There is no suggestion in the history of the 1966 legislation that Congress intended to preclude bank holding companies from serving as investment advisers to closed-end investment companies, which issue their shares only on an infrequent basis.

3. The 1970 amendments to the Bank Holding Company Act revised Section 4(c)(8) and produced the current text of that provision. See 84 Stat. 1765. Once again, Congress reaffirmed that it intended the Board to draw the line between permissible and impermissible non-bank activities and that it did not wish to preclude the Board from approving any business activities closely related to banking except those activities forbidden by the Glass-Steagall Act.

As amended, Section 4(c)(8) authorizes the Board to permit a bank holding company to acquire "shares of any company the activities of which the Board * * * has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." 84 Stat. 1765. The 1970 amendments did not contract the range of activities that the Board was empowered to approve.[42]

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[42] In fact, Congress enlarged the range of activities covered by the statute. The 1970 amendments replaced the phrase "business of banking" appearing in the original version of Section 4(c)(8) with the word "banking." 84 Stat. 1765. The Board had interpreted the phrase "business of banking" to require a close connection between the proposed new activities of a bank holding company and the activities in which it

In discussing the 1970 revision of Section 4(c)(8), the Chairman of the Conference Committee emphasized repeatedly that the statute was not intended to change the rules prescribed under the Glass-Steagall Act. To the contrary, the Glass-Steagall Act defined the outer boundaries of permissible activities under Section 4(c)(8). See 116 Cong. Rec. 42430 (1970) (emphasis supplied):

> [Senator] Williams. Both the Senate and House bills contained, in section 4(c)(8), substantially similar language reiterating the existing law embodied in the Glass-Steagall Act which provides, essentially, for separation of commercial banking and the securities business. This language does not appear in the bill agreed to by the conferees. I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may

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actually engaged. Under the amended language, only a close connection between the proposed activity and the business generally conducted by banks is required. H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. 21 (1970); S. Rep. No. 91-1084, 91st Cong., 2d Sess. 12 (1970). Thus, contrary to the view of the court of appeals (Pet. App. 38a), the 1970 amendment to Section 4(c)(8) contemplated some enlargement of the lines of business in which bank holding companies could lawfully engage. See 116 Cong. Rec. 42423-42424, 42435 (1970) (remarks of Sens. Sparkman and Bennett).

The 1970 amendments also deleted the qualifying phrase "of a financial, fiduciary or insurance nature" in Section 4(c)(8). Congress believed that this phrase was redundant. Its elimination was not intended to have any limiting effect on the scope of Section 4(c)(8). See H.R. Conf. Rep. No. 91-1747, *supra*, at 14-15; S. Rep. No. 91-1084, *supra*, at 15.

nevertheless be engaged in by bank-holding companies or their non-banking affiliates.

[Senator] Sparkman. The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. *There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here.* We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. The provision to which you referred is already complicated enough. *In short, we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank holding companies or any of their affiliates, now contained in the Glass-Steagall Act.* If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation. I hope there is no longer any misconception on that point.

[Senator] Williams. *It is reassuring, indeed, to know that the Glass-Steagall Act has not been disturbed in any way and that there is no intention at all here to do so.*

By emphasizing that the 1970 amendments to the Bank Holding Company Act neither enlarged nor contracted existing Glass-Steagall Act prohibitions and exemptions, Senator Sparkman made clear that the amendments did not prohibit activities permissible under the Glass-Steagall Act. The import of

these views is that the permissibility of activities involving securities should be judged by the terms of the Glass-Steagall Act, not by an amorphous prohibition of "securities related" activities read into Section 4(c)(8).[43]

The legislative history of the 1970 amendments contains no evidence that Congress believed that organization and management of a closed-end investment company were activities inappropriate for a bank holding company. Services to investment companies were discussed in the Senate Report on the 1970 amendments, but that Report referred only to open-end investment companies and expressly disavowed any intention to prohibit the operation of such companies. See S. Rep. No. 91-1084, *supra*, at 15:

> [T]his provision is not intended to prejudice the rights of banks or bank holding companies or their affiliates to engage in such of these activities as may be permitted under existing law or which may become permissible under this legislation or under any future legislation. In particular, the language is not intended to inhibit

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[43] The court of appeals repeatedly states that the Bank Holding Company Act did not "cut back on the prohibitions against securities activities contained in the Glass-Steagall Act" (Pet. App. 39a, 32a). This is true, but it is equally true that it did not *enlarge* the prohibitions of the Glass-Steagall Act, as the colloquy between Senators Sparkman and Williams makes clear.

> * * * operating commingled or managing agency accounts (bank sponsored mutual funds) * * *.[44]

Thus, the Senate Committee believed that even open-end investment companies (mutual funds) might be managed by bank holding companies if permissible under the Glass-Steagall Act. These views apply with even greater force to closed-end investment companies, which issue securities only on an infrequent basis (see pages 24-27, *supra*).

Finally, as the court of appeals recognized (Pet. App. 39a-40a), a prohibition in the House version of Section 4(c)(8) that would have precluded the Board from permitting holding companies to engage in the issuance or underwriting of securities whether or not such securities were redeemable was stricken from the bill that was ultimately enacted. See 115 Cong.

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[44] In 1970, the permissibility of "bank sponsored mutual funds" under the Glass-Steagall Act was unsettled. The D.C. Circuit had approved operation of such funds. See *National Association of Securities Dealers* v. *SEC*, 420 F.2d 83 (1969). After the 1970 amendments to the Bank Holding Company Act were enacted, this Court reversed the D.C. Circuit's decision. *Investment Company Institute* v. *Camp*, *supra*. In light of the fact that existing judicial precedent in 1970 favored the operation of open-end investment companies (mutual funds) by banks, there is little basis for inferring that Congress believed that such activities were forbidden by the Glass-Steagall Act. There is certainly no basis for concluding that Congress believed that *closed-end* funds would infringe the Glass-Steagall Act. As previously noted (see page 26, *supra*), the Board has long interpreted the Glass-Steagall Act to permit affiliations between banking organizations and closed-end investment companies. See 12 C.F.R. 218.102, 218.104(d).

Rec. 33133, 33139 (1969).[45] This prohibition was part of the "negative laundry list" that the House believed should be adopted to confine the discretion of the Board. That restrictive approach to Section 4(c)(8) was rejected by the Conference Committee,[46] which left to the Board the task of delineating those activities closely related to banking[47] and adopted the Glass-Steagall Act as the standard for evaluating connections between commercial and investment banking institutions (see pages 48-50, *supra*).[48]

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[45] The court of appeals was of the view that the language in the House bill would have barred bank holding companies from "operation of closed-end investment companies" (Pet. App. 39a-40a). However, there is no evidence in the legislative history that the House so understood this phraseology, which describes investment banking activities and not fiduciary management services. Indeed, Representative Patman, an advocate of the "negative laundry list" approach, believed that the phraseology was aimed at the underwriting of "mutual fund" (open-end investment company) shares. See 115 Cong. Rec. 32897, 33135 (1969).

[46] The statement of the House managers accompanying the Conference Report does not address the permissibility of securities activities of bank holding companies. It contains no suggestion that standards other than those prescribed in the Glass-Steagall Act should be applied to such activities. See H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. (1970).

[47] In the words of Senator Sparkman: "We reached a decision [in conference] that the whole thing ought to be flexible, that it ought to be lodged in the hands of the Federal Reserve Board to carry out the guidelines we set." 116 Cong. Rec. 42429 (1970).

[48] The decision of the court of appeals places reliance on certain statements of Dr. Charls Walker (then Under Secretary of the Treasury) to the Senate Committee on Banking

In sum, the legislative history of the Bank Holding Company Act reiterates a continuing theme: delineation of activities closely related to banking is a function committed to the Board's expert judgment. Section 4(c)(8) was not intended to create a new prohibition against "securities related" activities of bank holding companies. Congress believed that the Bank Holding Company Act would not disturb the coverage of the Glass-Steagall Act "in any way." 116 Cong. Rec. 42430 (1970).

C. Organization and management of closed-end investment companies are activities "closely related" to the traditional fiduciary activities of commercial bank trust departments

1. Because the management of a closed-end investment company by a bank holding company is consis-

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and Currency. Dr. Walker indicated that bank affiliates should not manage "mutual funds" (*open-end* investment companies), although he believed that banks should be permitted to do so directly (see Pet. App. 41a-42a). However, as previously noted, the Senate Committee Report shows that its members did not accept Dr. Walker's assessment, concluding that bank holding company operation of mutual funds would be appropriate if permissible under the Glass-Steagall Act. See pages 50-51, *supra*. Moreover, Dr. Walker never suggested that bank affiliates should not operate *closed-end* investment companies.

The court of appeals states that the expression "mutual fund," as used by Dr. Walker, may refer to a closed-end investment company (Pet. App. 44a n.63). But nowhere in the legislative history of the 1970 amendments is there an indication that Congress or the witnesses who appeared before it used such a misnomer. See *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 625 n.11: "A mutual fund is an open-end investment company."

tent with the Glass-Steagall Act (see pages 19-39, *supra*), the court of appeals should have upheld the Board's regulation and interpretive ruling under Section 4(c)(8) unless it concluded that such activities could not rationally be classified as "closely related" to banking. The court of appeals did not, however, analyze this question at all, and it suggested no basis for disagreeing with the Board's determination that the management activities here in issue are "so closely related to banking or managing or controlling banks as to be a proper incident thereto" (Pet. App. 81a, 83a).[49]

A business activity is properly viewed as "closely related" to banking if banks generally engage in that activity or if banks engage in activities that are similar. See, *e.g.*, *National Courier Association* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1237 (D.C. Cir. 1975). Organization and management of a closed-end investment company are activities appropriate for a bank holding company within this standard. That conclusion is strongly supported by Section 4(c)(7) of the Act, which, as previously noted (see pages 42-43, *supra*), permits a bank holding company to control and manage an investment company subsidiary in addition to controlling and managing bank subsidiaries.

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[49] Respondent's challenge to the Board's regulation and ruling before the Board and the court of appeals rested on Sections 16 and 21 of the Glass-Steagall Act. Respondent never contended that, as a factual matter, the business of managing a closed-end investment company is not "closely related" to banking under Section 4(c)(8).

As the Board explained, bank trust departments have traditionally organized and managed large collective investment funds such as common trust funds and pooled employee benefit funds, which include the assets of corporations, pension plans, charitable organizations, and individuals. These are conventional fiduciary services. See Pet. App. 62a; *SEC Report on Investment Trusts and Investment Companies* (*Supplemental Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies*), H.R. Doc. No. 476, 76th Cong., 2d Sess. 7-16, 25-26 (1939); 12 C.F.R. 9.18; A. 4-8, 17-22. It is evident that managing a closed-end investment company is "closely related" to such traditional services. Indeed, available statistics show that commercial banks and trust companies have, both before and after the enactment of the Glass-Steagall Act, sponsored and organized a significant number of closed-end investment companies. See *SEC Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 70 (Part 2), 76th Cong., 1st Sess. 57-58, 124 (Table 25) (1939). In 1929, commercial banks and trust companies sponsored closed-end investment companies with $71 million in assets; in 1935, commercial banks and trust companies sponsored closed-end investment companies with $78 million in assets.[50] Today, banking institutions provide

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[50] Since the adoption of the Board's regulation and interpretive ruling in 1972, fully one-third of the major closed-end investment companies that were organized were organized by banking institutions. See Wiesenberger Investment Companies Service, *Investment Companies* 572-575, 596-610 (1979).

a broad spectrum of management services to investment companies. See *SEC Final Report on Bank Securities Activities* 146-148 (1977): "The extent to which the largest 115 banks and their affiliates provide investment management and advice to investment companies is shown [in an attached table]. The data show that slightly more than $2 billion in investment company assets receive some degree of advice from banks; $583.6 million of this amount represents investment company assets over which banks have sole investment authority." Accord, *SEC Institutional Investor Study Report*, H.R. Doc. No. 92-64 (Part 2), 92d Cong., 1st Sess. 162, 140 (1971).[51]

2. Although the court of appeals did not analyze the closeness of the relationship between banking and managing a closed-end investment company, it did refer to the possibility that permitting a bank holding company to manage a closed-end investment company could lead to an undue aggregation of economic power or to unsound banking practices. See Pet. App. 46a. However, those are not questions that can be addressed in the abstract. The Board screens each bank holding company application to determine whether the statutory criteria are satisfied. See note

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[51] The Board's regulation applies only to closed-end investment companies that are registered under the Investment Company Act of 1940 (Pet. App. 80a), and thus does not suggest that closed-end investment companies managed by bank holding companies are exempt from the requirements of the Securities Act of 1933, 15 U.S.C. 77a, 77c(a)(2), or the Investment Company Act of 1940, 15 U.S.C. 80a-1, 80-3.

2, *supra*; see also 12 C.F.R. 225.4(b); *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp., supra.* In passing on an application by a particular bank holding company to serve as an investment adviser, the Board must determine whether the public benefits likely to result from the performance of the activity by the particular applicant outweigh possible adverse effects, including "undue concentration of resources" and "unsound banking practices." Thus, the bare possibility of undue concentration of resources or unsound banking practices in a particular case does not undermine the Board's generic determination that management of a closed-end investment company is an activity closely related to the traditional fiduciary business of commercial banks.[52]

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[52] The Board is empowered to deny applications of bank holding companies proposing to serve as investment advisers if the proposed new activities threaten to result in "decreased or unfair competition" or "undue concentration of resources." 12 U.S.C. 1843(c)(8); 12 C.F.R. 225.4(b). The Board is also equipped to deal with unsound banking practices in bank holding companies and their subsidiaries. See 12 U.S.C. 1818(b)(1), (3); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3646.

The court of appeals suggests that management of a closed-end investment company might cause the subsidiary of the holding company to lend money indiscriminately to corporations issuing securities held in the advisee's investment portfolio or to deny credit to competitors of those companies (Pet. App. 45a). The court does not explain why the commercial department of a bank would behave in this way. Moreover, the same speculative hypothesis could be advanced whenever a bank holds securities as trustee or managing agent. The Board and the Comptroller of the Currency super-

Moreover, as the Antitrust Division of the Department of Justice pointed out during proceedings before the Board on its proposed regulation (A. 10-16), new entry by bank holding companies (operating within the restrictions of the Glass-Steagall Act) would have a significant pro-competitive effect in the investment advisory industry. The entry of bank holding companies and their non-bank subsidiaries into the investment advisory industry would produce important new options for the investing public. Bank holding companies serving as investment advisers have already organized a substantial number of new closed-end investment companies (see note 50, *supra*). Bank holding companies could also extend their services to previously existing investment companies that wish to change their investment advisers in an effort to improve their economic performance (see note 7, *supra*). Thus, far from impairing competition in the investment advisory industry, the entry of bank holding company advisers—subject to the Board's supervision to prevent anticompetitive practices and undue concentration of resources—will significantly increase actual and potential competition. See Note,

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vise national banks and holding companies to assure that conflicts of interest of this kind do not arise. The suggestion of the court of appeals that subsidiary banks might be tempted to disclose "confidential information about their depositors" (Pet. App. 45a) to investment adviser affiliates requires only brief comment. Such unethical conduct would be a breach of fiduciary duty in violation of state law as well as an unsound banking practice subject to correction by the federal bank regulatory agencies.

The Legality of Bank-Sponsored Investment Services, 84 Yale L.J. 1477, 1485 (1975).

3. The decisions of this Court establish that the Board's interpretations of the federal banking laws are entitled to judicial deference (see pages 37-39, *supra*). That basic principle applies both under the Glass-Steagall Act and the Bank Holding Company Act. As a consequence, a regulation promulgated by the Board which determines that a particular activity is "closely related to banking" should be upheld unless the Board's determination is arbitrary or capricious. See *National Courier Association* v. *Board of Governors of the Federal Reserve System*, *supra*, 516 F.2d at 1235-1237; *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, *supra*, 568 F.2d at 552; see also *Camp* v. *Pitts*, 411 U.S. 138, 140-142 (1973).

The Board's determination that organization and management of a closed-end investment company is an activity closely related to banking and therefore is permissible for a bank holding company is not an arbitrary or capricious determination. As we have shown, nothing in the text or history of the Bank Holding Company Act or the Glass-Steagall Act precludes that determination. Under these circumstances, the court of appeals should have upheld the Board's regulation and interpretive ruling.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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MAY 1980

APPENDIX

1. Section 2(b) of the Glass-Steagall Act, 12 U.S.C. 221a(b), provides in pertinent part:

> Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization—
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> * * * * *
>
> (2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank * * *
>
> * * * * *
>
> (4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

2. Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, provides in pertinent part:

> * * * The business of dealing in securities and stock by the [national banking] association shall

be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock * * *.

3. Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, provides in pertinent part:

> After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities: * * *.

4. Section 21(a)(1) of the Glass-Steagall Act, 12 U.S.C. 378(a)(1), provides in pertinent part:

> After the expiration of one year after June 16, 1933, it shall be unlawful
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> * * * * *
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> For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor * * *.

5. Prior to its repeal in 1966, Section 19 of the Glass-Steagall Act, ch. 89, 48 Stat. 186-188, 12 U.S.C. (1964 ed.) 61, provided in pertinent part:

> * * * For the purposes of this section * * * [national bank] shares shall be deemed to be controlled by a holding company affiliate if they are owned or controlled directly or indirectly by such holding company affiliate, or held by any trustee for the benefit of the shareholders or members thereof.
>
> Any such holding company affiliate may make application to the Board of Governors of the Federal Reserve System for a voting permit entitling it to vote the stock controlled by it * * *. The Board of Governors of the Federal Reserve System may, in its discretion, grant or withhold such permit as the public interest may require * * * but no such permit shall be granted except upon the following conditions:
>
> * * * * *
>
> (e) Every such holding company affiliate shall, in its application for such voting permit, (1) show that it does not own, control, or have any interest in, and is not participating in the management or direction of, any corporation, business trust, association, or other similar organization formed for the purpose of, or engaged principally in, the issue, floatation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort (hereinafter referred to as "securities company"); (2) agree that during the period

that the permit remains in force it will not acquire any ownership, control, or interest in any such securities company or participate in the management or direction thereof; (3) agree that if, at the time of filing the application for such permit, it owns, controls, or has an interest in, or is participating in the management or direction of, any such securities company, it will, within five years after the filing of such application, divest itself of its ownership, control, and interest in such securities company and will cease participating in the management or direction thereof, and will not thereafter, during the period that the permit remains in force, acquire any further ownership, control, or interest in any such securities company or participate in the management or direction thereof * * *.

6. Section 4(a) of the Bank Holding Company Act, 12 U.S.C. 1843(a), provides in pertinent part:

> Except as otherwise provided in this Act, no bank holding company shall—
>
> > (1) after May 9, 1956 acquire direct or indirect ownership or control of any voting shares of any company which is not a bank * * *.

7. Section 4(c) of the Bank Holding Company Act, 12 U.S.C. 1843(c), provides in pertinent part:

> The prohibitions in this section shall not apply to
>
> * * * * *
>
> > (7) shares of an investment company which is not a bank holding company and

which is not engaged in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting shares of any company;

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern;

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